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## **The Impact of Non-Traditional Food Retailers on Produce Distribution**

by

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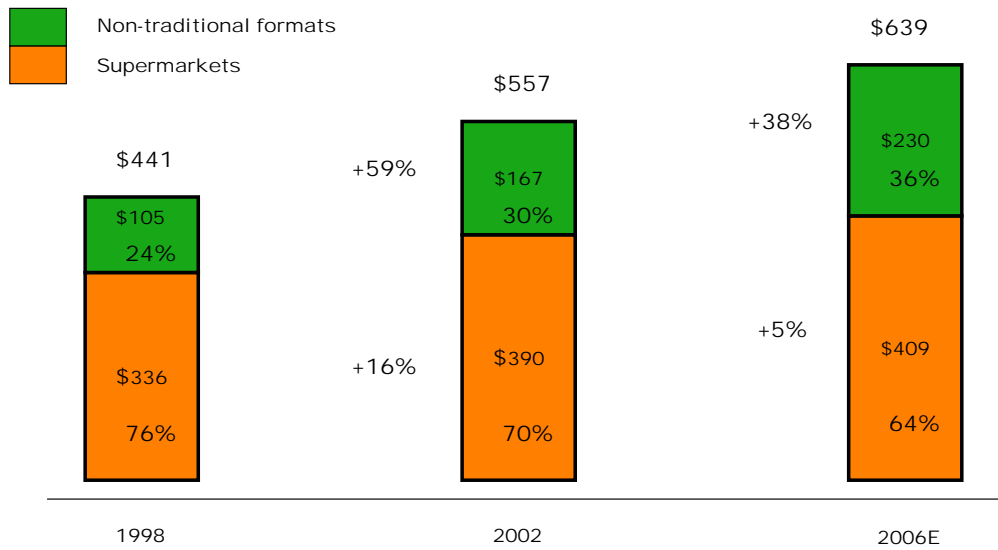
Sweeping changes in the structure of U.S. food retailing are having a dramatic impact on the business models and go-to-market strategies of produce suppliers. Gone are the days where a shipper could execute a single “one-size-fits-all” strategy that aligned with the business models of largely homogenous traditional supermarket customers. New forms of retailing, each operating with distinctive and unique business models, are requiring suppliers to develop new competencies and execute a portfolio of strategies.

Food retailing is becoming increasingly fragmented as the market share of the traditional supermarket loses share to a number of relatively new and rapidly growing formats.

For the six years ending in 2006, it is estimated that non-traditional formats will have captured 12 points of market share from the traditional supermarket segment.

What are these non-traditional formats? Who are the leading companies? Most importantly, what are the unique characteristics of the business models to which produce suppliers must adapt?

## Retail Food Sales: Traditional vs. Non-Traditional Channels



Source: Management Ventures Inc.

Food Sales includes: perishables, dry grocery, dry grocery related items

## The Non-Traditional Segments

Format	Differentiating Characteristics
<b>Hypermarkets</b>	<ul style="list-style-type: none"> <li>•Combination of food and general merchandise</li> <li>•Full "one-stop-shop"</li> <li>•Low price position</li> <li>•Low-middle income consumer target</li> </ul>
<b>Wholesale Clubs</b>	<ul style="list-style-type: none"> <li>•Combination of food and general merchandise</li> <li>•Edited, high velocity assortments</li> <li>•Unique combination of low price and high quality</li> <li>•No frills shopping experience</li> <li>•B to B, middle-high income consumer targets</li> </ul>
<b>Extreme Value</b>	<ul style="list-style-type: none"> <li>•Small stores, convenient shopping experience</li> <li>•Market-leading opening price points</li> <li>•Low-middle income consumer target:</li> </ul> <p><b>Limited Assortment: Food driven; high velocity assortments</b></p>
<b>Specialists</b>	<ul style="list-style-type: none"> <li>•Category Killers</li> <li>•Service and product expertise</li> <li>•High Quality</li> <li>•Upscale and/or ethnic consumer appeal</li> </ul>

Hypermarkets, the largest of the non-traditional segments at approximately \$150 billion in annual sales (2004) are dominated by the Wal-Mart Supercenter. With a one-stop-shop offering of food and general merchandise and everyday low prices (EDLP), the Wal-Mart Supercenter holds an 85% share of the concentrated hypermarket segment.

Wholesale Clubs, with 2004 sales of approximately \$90 billion, is the second largest of the non-traditional formats. This segment is also concentrated, with Costco and Wal-Mart subsidiary Sam's Club owning a combined 90+ % of the segment's market share.

The Extreme Value segment, with \$37 billion in sales, is smaller yet more diverse. Aldi and Save-A-Lot, with combined annual volume approaching \$12 billion, are both food-based, limited assortment formats that offer severely edited selections of food products at market-leading prices. Family Dollar and Dollar General, both non-food-based formats that offer basic assortments of food products, dominate the Convenience Discount sub-segment. The Dollar Store sub-segment consists of a fragmented group of retailers that sell food and non-food at fixed prices – usually \$1.00.

The Specialists are a diverse and fragmented group of formats that position themselves around either a focused food product offering (fresh produce specialty stores) or a focused customer segment or group of segments. Most prominent and rapidly growing at present is Whole Foods, which targets the organics/natural and upscale food customer segments.

With the exception of the Specialists segment, the non-traditional formats share certain business model characteristics that require unique approaches that differ substantially from historical strategies deployed against the traditional supermarket segment:

- A consumer proposition rooted in everyday low prices
- Demand net pricing
- High sales volumes per SKU relative to conventional supermarkets
- Item merchants (as opposed to category merchants)
- Cultures of simplicity
- Importance of packaging in marketing and operations.

Everyday low pricing, and a desire to be lowest priced in the market at the SKU level, is the overarching commonality that drives many of the unique characteristics. An EDLP position is generally “margin unfriendly” to suppliers. The importance of price, combined with comparatively narrow food assortments, places the burden of fact driven price justification on

suppliers rather than the traditional promotion–based negotiations that have historically characterized retailer–supplier relationships. In addition, these retailers by demanding either lower prices on identical products or measurable improvements at the same price increasingly desire a cycle of continuous product attribute improvement.

Typically, the non-traditional retailers operate on the basis of “net pricing” – eschewing many of the inefficient promotional and merchandising practices of traditional supermarketers - such as slotting fees, promotional and trade allowances - in favor of the lowest landed everyday net cost.

The category management selling practices that have been developed to align with traditional supermarkets are less applicable in the case of these price–based, non-traditional retailers, as most offer narrow assortments and adopt an item, rather than category merchandising, approach. High velocity at the SKU levels provides these retailers a degree of scale that is disproportionate to their size and places a high premium on meaningful product and item innovation.

Finally, most of the non-traditional retailers operate with what can be termed “cultures of simplicity”. In their drive to lower costs and consumer prices, these retailers outsource complexity to their suppliers. Examples include custom palletization requirements; self-selling, unique secondary packaging; shrink control build-ins; pre-pricing; vendor managed inventories; superior in-stock performance; and likely in the future – RFID capabilities.

Together, the non-traditional formats are serving as an impetus for change among suppliers. It is essential that suppliers understand this new breed of retailers and their unique characteristics if effective and profitable response strategies are to be developed. Most importantly, the supply chain innovations, cost reductions and uniqueness desired by these retailers are not “one-way” - they stand to benefit retailers and suppliers alike. New and collaborative growth models are emerging that contrast sharply with the inefficient and tradition-bound practices that characterize the traditional supermarket segment.

**Smart Marketing** is a monthly marketing newsletter for extension publication in local newsletters and for placement in local media. It reviews the elements critical to successful marketing in the food and agricultural industry. Articles are written by faculty members in the Department of Applied Economics and Management at Cornell University.

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